



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201141021**
Release Date: 10/14/2011
Date: July 19, 2011
UIL Code: 501.03-00
501.03-30

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:
1120

Tax Years:
All Years

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: May 12, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Uniform Issue List:

501.03-00

501.03-30

Legend:

M =

N =

Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

FACTS:

You were incorporated under the nonprofit laws of the State of M. Article III of your Articles of Incorporation provides that you were formed to assist, develop, build and operate community based information and electronic communication resources to link individuals, businesses, educational, cultural and social institutions, and local government and to conduct all other lawful businesses as permitted by the State of M.

You are a consulting firm which was formed to provide services to various governmental units and non-profit organizations (the "Clients") within and outside the state of M. You offer the following commercially available services for a fee: assistance with respect to applying for federal and state grants and with respect to the planning and funding stages of Fiber-to-the Premises ("FTTP Network") which includes business planning, engineering, construction, project management and operation of such networks. Your fee structure is similar to that of for profit entities offering similar services.

In your letter dated November 6, 2010, you state that you meet with prospective Clients to explain the services that you can provide. Once a Client contracts with you to construct an FTTP Network, you will work with that Client to coordinate the financing, construction, implementation and maintenance of the network. The FTTP Networks constructed pursuant to your contracts will be owned by your Clients. With respect to grant applications you prepare, grants are awarded to your Clients rather than you.

Upon completion of an FTTP Network, your Clients will provide internet, telephone and cable services ("telecommunication services") to area residents (the "subscribers") for a fee. Fees will be paid to the Client by the subscribers. Your role will be to provide maintenance and administrative services to the Client which facilitates the Client's provision of such telecommunication services. In some cases, the Client will choose not to directly provide services using the FTTP Network. Rather, it will lease access to the network to interested entities, both for profit and non-profit. Those entities will then directly provide telecommunication services to subscribers. In those cases, you may elect to lease access to the FTTP Network from your Client and directly provide telecommunication services. You will charge subscribers a fee that is set to cover your cost of providing the services. In your letter dated October 18, 2010, you explain how you will differ from for profit firms providing telecommunication services. You state, "In summary, conventional for-profit companies attempt to provide the least possible services at the highest possible cost. We attempt to provide the highest level services at the lowest possible cost."

Currently, you provide consulting services to N (the "County"). The County issued a request for proposals from consulting firms to help it design, build and operate a FTTP Network. You were awarded the contract through this competitive bidding process. Pursuant to the contract, you will design, build and maintain a FTTP Network for the County. The FTTP Network will be owned by the County. The fees for your consulting services are set to cover your cost of providing such services.

The County plans to provide telecommunication services to the public utilizing its FTTP Network. The County will have a contractual arrangement with subscribers who receive telecommunication services for a fee. The County will contract with you to provide the maintenance of the FTTP Network and to perform administrative and billing services on its behalf. You will provide this service to the County for a fee that is set to cover your cost of providing the service.

You are supported by income derived from fees for consulting and other services provided to your Clients. In the future, you will also be supported by fees from subscribers for the telecommunication services you will provide.

You are controlled by a five-member board of directors. Your governing board is self-perpetuating. Each member of your governing board is either an owner or employee of a commercial consulting firm which specializes in telecommunications. You provide

compensation to four of your five directors. These are the only individuals you employ. In your letter dated October 18, 2010, you state that you do not use national surveys to determine compensation levels, you have not established any caps on their compensation levels and you do not have written employment contracts with your officers and directors.

You are not controlled by your Clients nor will they have control over your day-to-day operations. Your Clients' relationship with you is solely contractual.

There is no statute requiring your creation. There is no legislative acknowledgement of governmental responsibility with respect to the provision of telecommunication services.

LAW:

Section 501(c)(3) of the Code provides, in part, for exemption from federal income tax of organizations organized and operated exclusively for charitable, religious or educational purposes, provided no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations (the "regulations") provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section a.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization: (a) limit the purposes of such organization to one or more exempt purposes; and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iii) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is not broader than the purposes specified in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) of the regulations defines private shareholder or individual as a person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Therefore, to meet the requirement of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" in section 501(c)(3) in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged; advancement of religion and, advancement of education or science.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3), although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose and if the organization is not organized and operated for the primary purpose of carrying on an unrelated trade or business.

Rev. Rul. 71-529, 1971-2, C.B. 234, held that a nonprofit organization that provides assistance in the management of the endowment or investment funds of its member colleges and universities for a charge that is less than 15 percent of its total operating costs qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 72-369, 1972-2 C.B. 245, held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable for purposes of section 501(c)(3). The ruling concluded that furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

In *B.S.W. Group, Inc. v. Commissioner of Internal Revenue*, 70 T.C. 352 (1978) ("*BSW Group*"), the Tax Court held that a corporation formed to provide consulting services was not exempt under section 501(c)(3) of the Code because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures

organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. The court found that the corporation had completely failed to demonstrate that its services were not in competition with commercial businesses. The court found that the organization's financing did not resemble that of the typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees for services, and those fees were set high enough to recoup all projected costs, and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost". And finally, the corporation had failed to limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In *Better Business Bureau of Washington D.C. Inc. v. United States*, 326 U.S. 279, 66 S. Ct. 112, 90L. Ed. 67, 1945 C.B. 375 (1945) (*Better Business Bureau, Inc.*), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

RATIONALE:

Section 1.501(c)(3)-1(a) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more purposes specified that section. These tests are independent and an organization must satisfy both to be exempt.

Article III of your Articles of Incorporation provides, among other things, that you were formed to assist, develop, build and operate community based information and electronic communication resources to link individuals, businesses, educational, cultural and social institutions, and local government and to conduct all other lawful business as permitted by the State of M. Providing the type of services described at Article III does not further an exempt purpose. Furthermore, this Article authorizes you to conduct any lawful business as permitted by the State of M. Thus, Article III authorizes you to conduct activities outside the scope of section 501(c)(3) of the Code. Accordingly, you do not meet the organization test described at section 1.501(c)(1)-1(b) of the regulations.

You were formed to provide consulting and administrative services to governmental units and non-profit organizations for a fee that is set to cover your cost of providing these services. In addition, you will provide telecommunication services to the public for a fee that is set to cover your cost of providing the services. These are your sole activities. To obtain your contract with N, you participated in a competitive bidding process along with for profit entities providing similar business services. The type of telecommunication services you provide will also be provided by for profit entities.

An organization providing services of a commercial nature, regardless of whether the undertaking is conducted on a nonprofit basis, will not qualify for exemption unless the provision of those services directly furthers an exempt purpose. For example, the organization described in Rev. Rul. 71-529, *supra.*, qualified for exemption although it provided services of a commercial nature. It provided the services solely to organizations described in section 501(c)(3) of the Code at 15 percent of its cost, effectively donating the services. You do not operate like the organization described in section Rev. Rul. 71-529. You provide your services at cost, you do not limit your clients to governmental entities and organizations described in section 501(c)(3) and you directly compete with for profit entities providing similar services. You operate in a manner similar to *BSW Group, Inc.*, *supra.* The court held that *BSW Group, Inc.*, did not qualify for exemption under section 501(c)(3) since it provided its services at cost, did not limit its clientele to organizations described in section 501(c)(3) and failed to demonstrate that its services were not in competition with commercial businesses. See also Rev. Rul. 72-369, *supra.*, which held that an organization providing services at cost to organizations described in section 501(c)(3) did not qualify for exemption.

Your only purpose is to provide consulting, administrative and telecommunication services. Provision of these services constitutes 100 percent of your activities. Providing these services does not further an exempt purpose. Thus, you are not operated exclusively for one or more exempt purposes. See *Better Business Bureau Inc.*, *supra.*, which held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

Further, you have not established that your funds will not inure to the benefit of your directors. You provide compensation to four of your five directors, individuals who control your operations. In your letter dated October 18, 2010, you state that you do not use national surveys to determine compensation levels, you have not established caps on compensation levels and you do not have written employment contracts with your directors. Based on these statements, it is clear that you have not established safeguards to insure that your directors will not receive unreasonable levels of compensation.

You do not meet the operational test described at section 1.501(c)(3)-1(c)(1) of the regulations nor have you established that you are not organized or operated for private benefit as required by section 1.501(c)(3)-1(d)(ii).

You do not satisfy the requirements of section 1.501(c)(3)-1(e)(1) of the regulations since your operation of a trade or business is not in furtherance of an exempt purpose.

CONCLUSION:

Based on the information above, you have failed to demonstrate that you are organized or operated exclusively for charitable or educational purposes within the meaning of section 501(c)(3) of the Code. Accordingly, we conclude that you do not qualify for exemption under section 501(c)(3).

Because you do not qualify for exemption as an organization described in section 501(c)(3) of the Code, you must file Federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service

1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations